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TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF U.S., MAY 31

REF: OECD DOCUMENT EDR(74)14

1. SUMMARY. SPIRITED DISCUSSION AT US ANNUAL REVIEW REVEALED SHARP DIFFERENCES IN OUTLOOK BETWEEN SECRETARIAT AND US. SECRETARIAT GENERALLY MORE PESSIMISTIC ABOUT PROSPECTS FOR SPONTANEOUS RECOVERY AND EMPHASIZED NEED FOR US TO TAKE APPROPRIATE MEASURES TO MAINTAIN LEVEL OF ACTIVITY, IF ONLY TO HOLD UP DEMAND FOR IMPORTS FROM OECD DEFICIT COUNTRIES. US DEL (STEIN) TOOK VIEW THAT PROSPECTS FOR RECOVERY WERE GOOD, THAT CONTROL OF INFLATION REQUIRED CONTINUED RESTRICTIVE POLICY STANCE, AND THAT BALANCE OF PAYMENTS ADJUSTMENTS SHOULD TAKE PLACE THROUGH FLUCTUATIONS IN EXCHANGE RATES RATHER THAN THROUGH STIMULATION OF DEMAND IN SURPLUS COUNTRIES. SECRETARIAT AND US AGREED US WOULD CONTINUE TO EMPHASIZE FIGHT AGAINST INFLATION BUT WOULD ALSO CONTINUE BE PREPARED TAKE NECESSARY MEASURES TO ASSURE RECOVERY IF SPONTANEOUS FORCES PROVED INADEQUATE TO MAINTAIN DESIRED EMPLOYMENT LEVEL. SECRETARIAT RECOGNIZED THAT SUCCESS OF US ANTI-INFLATION PROGRAM COULD HELP REST OF WORLD TO CONTROL RISING PRICES. US NOTED THAT CURRENT ACCOUNT BALANCE WOULD PROBABLY SHOW LARGER DEFICIT THAN SECRETARIAT EXPECTED, AND THAT UNRESTRICTED CAPITAL FLOWS MIGHT BENEFIT REST OF WORLD ADJUSTMENT PROCESS. END SUMMARY.

2. ANALYSIS OF 1973 PERFORMANCE. ANNUAL REVIEW BEGAN ON LIVELY NOTE WHEN US DEL (STEIN) INDICATED FUNDAMENTAL DISAGREEMENT WITH SECRETARIAT ANALYSIS OF PAST US PERFORMANCE, FUTURE US PROSPECTS, AND POLICY RECOMMENDATIONS. REGARDING PAST PERFORMANCE STEIN NOTED THAT SLOW GROWTH OF OUTPUT IN FINAL THREE

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QUARTERS OF 1973 WAS LARGELY DUE TO SUPPLY SHORTAGES, NOT TO INADEQUATE DEMAND AS SUGGESTED BY SECRETARIAT. MOREOVER, HE REJECTED SUGGESTION PARA 58 REFDOK THAT FIRST QUARTER 1974 DECLINE IN GNP WAS DUE TO EROSION CONSUMER PURCHASING POWER AT TIME OF RAPID INFLATION. MAIN EXPLANATION OF FIRST QUARTER DROP WAS ENERGY CRISIS WHICH CAUSED REDUCTION IN DEMAND FOR AUTOMOBILES AND RELATED PRODUCTS. HE FURTHER DISAGREED

WITH SECRETARIAT ASSESSMENT THAT HIGH INFLATION WAS LEADING TO LOWER REAL INCOMES WHICH WERE IN TURN HOLDING DOWN CONSUMPTION, NOTING THAT UP UNTIL ENERGY PRICE RISES, EFFECT OF RISING PRICES WAS TO SHIFT INCOME FROM URBAN TO FARM WORKERS WITHOUT NET DECREASE IN REAL DISPOSABLE INCOME.

3. OUTLOOK FOR 1974. US DEL GENERALLY MORE OPTIMISTIC THAN SECRETARIAT REGARDING OUTLOOK FOR 1974. HE SAW GNP RISING AT RATE TOWARD TOP OF 2 TO 4 PERCENT RANGE IN SECOND HALF, WHILE SECRETARIAT ESTIMATED 1.5 PERCENT IN SECOND HALF AND 2 PERCENT FOR YEAR ENDING MID 1975. US DEL EXPECTED UNEMPLOYMENT TO RISE TO BETWEEN 5.5 AND 6 PERCENT WHILE SECRETARIAT SAW 6.25 PERCENT. MAIN DIFFERENCE OF VIEW WAS THAT US DEL SAW STRONG SPONTANEOUS FORCES FOR RECOVERY ONCE ENERGY SHORTAGES ARE REMOVED AND PRICES OF FOOD AND FUEL BEGIN TO STABILIZE, WHILE SECRETARIAT FEARED THAT RECOVERY WOULD BE DAMPENED BY MAINTENANCE OF MONETARY RESTRAINT TO CONTROL INFLATION. IN US

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VIEW, MAIN ELEMENTS OF STRENGTH ARE CONTINUED BUSINESS INVESTMENT DEMAND IN RESPONSE TO CAPACITY SHORTAGES OF 1973, REVIVAL OF AUTO PRODUCTION AS GASOLINE SHORTAGES DISAPPEAR, SLIGHT RECOVERY IN HOUSING DUE TO \$10 BILLION FISCAL STIMULUS TO MORTGAGE MARKET, AND CONTINUED GROWTH OF CONSUMER DEMAND AS FOOD AND ENERGY PRICES LEVEL OFF.

4. SECRETARIAT, SUPPORTED IN PART BY FRENCH AND CANADIAN EXAMINING COUNTRIES, EXPRESSED DOUBTS ABOUT SPONTANEOUS NATURE OF RECOVERY AND SHOWED CONCERN THAT RECOVERY MIGHT BE INADEQUATE WITHOUT SOME RELAXATION OF POLICY STANCE. IF PRESENT TIGHT MONETARY POLICY IS MAINTAINED TO CONTROL INFLATION, SECRETARIAT SEES DANGER OF CREDIT CRUNCH DISCOURAGING BOTH HOUSING AND BUSINESS INVESTMENT. MOREOVER, UNCERTAINTIES REGARDING WAGE PROSPECTS MIGHT GIVE ADDED IMPETUS TO INFLATION AND PROLONG USE OF RESTRICTIVE POLICIES.

5. OUTLOOK FOR PRICES AND WAGES: US DEL EXPECTED

CONSIDERABLE DROP FROM PRESENT 11.5 PERCENT RATE OF PRICE INCREASE BY END OF YEAR, AS PRICES OF FUEL, FOOD AND COMMODITIES RESPOND TO INCREASED SUPPLY AND SLOWER GROWTH OF OECD ECONOMIES. EVEN SO, RATE OF INCREASE WOULD STILL BE TOO HIGH AT 7 PERCENT AND MAXIMUM EMPHASIS WILL HAVE TO BE PUT ON INFLATION RESTRAINT. WAGES NOW RISING AT 8 PERCENT ANNUAL RATE, AND MAY ACCELERATE FURTHER. MAIN HOPE IS THAT WAGE DEMANDS WILL BE TEMPERED AS INFLATION RATE IS SEEN TO DECLINE. US DEL NOTED THAT WAGES TRADITIONALLY LESS RESPONSIVE TO PRICE RISES THAN TO SECTORAL INCOME DIFFERENTIALS, AND AT PRESENT THE LATTER ARE IN REASONABLE BALANCE. UK DEL SUGGESTED THAT INFLATIONARY EXPECTATIONS MIGHT LEAD TO INCREASED WAGE DEMANDS BEFORE PRICE LEVELS COULD STABILIZE, AS HAD HAPPENED IN UK.

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6. POLICY STANCE. US DEL DISAGREED WITH SECRETARIAT ASSESSMENT THAT RISKS OF INADEQUATE RECOVERY WERE SUCH AS TO REQUIRE STIMULATIVE DEMAND MEASURES. HE MADE CLEAR THAT INFLATION WAS NUMBER ONE POLICY PROBLEM, NOT OUTPUT, AND US WOULD HAVE TO MAINTAIN RESTRICTIVE STANCE WHETHER GNP GREW AT 2 OR 4 PERCENT. HOWEVER, HE AGREED THAT US DID NOT INTEND TO PUT ECONOMY THROUGH REAL CRUNCH, AND IF RECOVERY DID NOT MATERIALIZE, POLICY STANCE WOULD SHIFT ACCORDINGLY. US DEL DISAGREED WITH SECRETARIAT ASSUMPTION THAT GNP GROWTH RATE OF 2 PERCENT SHOULD BE SIGNAL FOR CHANGING POLICIES. BEST INDICATION WAS RATE OF UNEMPLOYMENT, AND US POLICY MIGHT BECOME MORE EXPANSIVE IF UNEMPLOYMENT EXCEEDED 6 PERCENT LEVEL. FOR THE MOMENT, BEST APPROACH WAS TO MAINTAIN STEADY RESTRAINT, AVOIDING SHARP CONTRACTION, IN ORDER TO SHOW DETERMINATION IN FIGHTING INFLATION.

7. MAIN THRUST OF ANTI-INFLATION PROGRAM WOULD BE THROUGH USE OF TRADITIONAL DEMAND MANAGEMENT POLICIES, SINCE DIRECT PRICE AND WAGE CONTROLS HAD PROVED INEFFECTIVE. IN RESPONSE TO GERMAN QUESTION REGARDING OTHER POSSIBLE MEASURES, STEIN SAID MOST IMPORTANT OF THESE WOULD BE TO ENCOURAGE INCREASES IN SUPPLY, ESPECIALLY IN AGRICULTURE.

8. US DEL TOOK PARTICULAR EXCEPTION TO SECRETARIAT VIEW WHICH STRESSED RESPONSIBILITY OF US TO PUMP UP ITS ECONOMY IN ORDER TO HELP OTHER OECD COUNTRIES RESOLVE THEIR BALANCE OF PAYMENTS DEFICITS. SECRETARIAT AND FRENCH CHAIRMAN NOTED IMPORTANCE OF US IN WORLD TRADE AND EXPRESSED CONCERN THAT RESTRICTIVE

DOMESTIC POLICIES WOULD REDUCE IMPORT DEMAND AND
POSSIBLY CALL FORTH RESTRICTIVE RESPONSES FROM
DEFICIT COUNTRIES. US DEL REJECTED THIS ARGUMENT
AND SUGGESTED THAT DEFICIT COUNTRIES SHOULD THEMSELVES
BE MAKING GREATER EFFORTS TO CONTROL INFLATION IF
THEY WANTED TO RESOLVE THEIR DEFICITS. PRIMARY US
RESPONSIBILITY WAS TO RESTRAIN INFLATION, AND IF IT
WAS SUCCESSFUL, THIS WOULD ALSO HELP COUNTER INFLATION
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IN REST OF WORLD. MAIN US CONTRIBUTION TO RRESOLUTION
OF OECD PAYMENTS DEFICITS WAS THROUGH REMOVAL OF CON-
TROLS ON CAPITAL OUTFLOWS AND CONTINUED MAINTENANCE
OF FLOATING EXCHANGE RATE. IF US INTEREST RATES
REMAIN HIGH AND LARGE QUANTITY OF PETROL DOLLARS
FLOW IN, THEN VALUE OF DOLLAR WILL BE PUSHED UP, RE-

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DUCING SIZE OF INFLOW AS WELL AS IMPROVING FOREIGN
IMPORT COMPETITIVENESS. ARGUMENT THAT US SHOULD
MAINTAIN EASY MONEY POLICIES TO HELP DEFICIT COUNTRIES
OBTAIN FINANCING ON REASONABLE TERMS WAS ALSO UN-
ACCEPTABLE, SINCE AT SOME POINT THESE COUNTRIES
WOULD HAVE TO MAKE STRUCTURAL ADJUSTMENTS RATHER THAN
CONTINUE BORROWING.

9. BALANCE OF PAYMENTS. US DEL (WIDMAN) STRESSED
GREAT UNCERTAINTIES IN FORECASTING PAYMENTS
POSITION, BUT NEVERTHELESS NOTED US EXPECTATION THAT
BOTH TRADE AND CURRENT ACCOUNT BALANCES WOULD SHOW
LARGER 1974 DEFICITS THAN FORECAST BY SECRETARIAT.
TRADE BALANCE MIGHT SHOW \$3 TO 5 BILLION DEFICIT,
WHILE SECRETARIAT SAW \$2.75 BILLION. MAIN REASON WAS
EXPECTED INCREASE IN OIL IMPORTS, WHICH WOULD BE
\$20 BILLION HIGHER IN 1974 THAN IN 1973, EVEN AFTER
CONSERVATION MEASURES. ON POSITIVE SIDE, AGRICULTURAL
EXPORTS MIGHT INCREASE ANOTHER \$3 TO 4 BILLION OVER
RECORD 1973 YEAR, ASSUMING PRICES DO NOT SOFTEN TOO

FAR. MANUFACTURING EXPORTS WILL INCREASE SUBSTANTIALLY AS BENEFITS OF EXCHANGE RATE DEVALUATION TAKE EFFECT. WIDMAN ALSO NOTED MAJOR REVISIONS IN 1972 AND 1973 BOP STATISTICS WILL HAVE EFFECT OF ADDING \$1 BILLION TO 1972 CURRENT ACCOUNT DEFICIT, DEDUCTING \$2 BILLION FROM 1973 SURPLUS AND INCREASING 1974 DEFICIT. US PAYMENTS POLICY WAS BASED ON PRINCIPLE THAT MARKET FORCES SHOULD DETERMINE EXCHANGE RATES AND STRUCTURE OF BOP, AND TO THIS END ALL RESTRAINTS ON CAPITAL FLOWS HAD BEEN REMOVED.

10. CONCLUDING POINTS. HELPFUL INTERVENTIONS BY SECRETARIAT (ATKINSON) AND CANADA (SLATER), PLUS SOME SOFTENING OF VIEWS, HELPED RESOLVE SOME OF DIFFERENCES BETWEEN SECRETARIAT/CHAIRMAN AND US. LIMITED OFFICIAL USE

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SECRETARIAT STUCK TO ASSESSMENT OF GREATER RISK ON OUTPUT SIDE, BUT AGREED TO GIVE GREATER EMPHASIS TO EXPECTATION OF RECOVERY AND TO MENTION IMPORTANCE OF US ANTI-INFLATIONARY EFFORT IN CONTEXT WORLD-WIDE EFFORTS TO CONTROL INFLATION. BOTH SIDES AGREED THERE SHOULD BE RECOVERY, AND IF NOT, SOME KIND OF STIMULATIVE MEASURES WOULD BE NEEDED. MAIN QUESTION WAS APPROPRIATE SIGNAL FOR CHANGING POLICY STANCE. BROWN

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